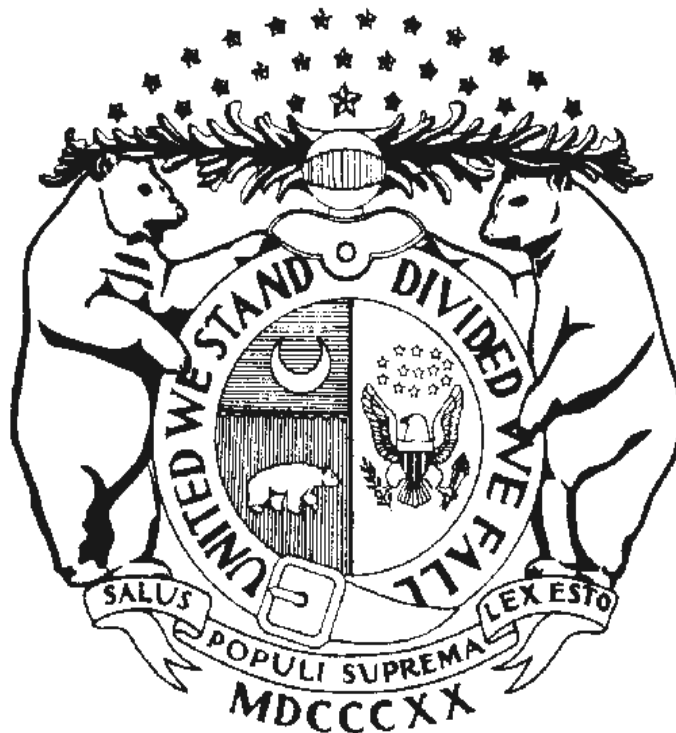


**REPORT OF THE
ASSOCIATION FINANCIAL EXAMINATION OF
SHELTER MUTUAL INSURANCE COMPANY**

**AS OF
DECEMBER 31, 2001**



**STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI**

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Columbia, Missouri
September 17, 2003

Chairman of Financial Condition (EX4) Subcommittee
Southeastern Zone Secretary
Honorable Alfred W. Gross, Commissioner
Virginia Bureau of Insurance

Midwestern Zone Secretary
Jim Poolman, Commissioner
North Dakota Department of Insurance

Honorable Scott B. Lakin, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

Shelter Mutual Insurance Company

hereinafter referred to as such, as Shelter Mutual, or as the Company. Its administrative office is located at 1817 West Broadway, Columbia, Missouri 65218, telephone number 573-445-8441. This examination began on November 4, 2002, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

The prior full scope association financial examination of Shelter Mutual was made as of December 31, 1998, and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC), with no other zones participating.

The current full scope association financial examination covered the period from January 1, 1999, through December 31, 2001, and was conducted by examiners from the State of Missouri, representing the Midwestern Zone of the NAIC, with no other zones participating.

This examination was conducted concurrently with the examinations of the Company's subsidiaries, Shelter General Insurance Company (Shelter General), Shelter Life Insurance Company (Shelter Life), and Shelter Reinsurance Company (Shelter Reinsurance). Shelter Mutual and its insurance subsidiaries are collectively referred to as the Shelter Insurance Companies in this report.

This examination also included the material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

Procedures

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance (MDI) and statutes of the State of Missouri prevailed.

The examiners relied upon information supplied by the Company's independent auditor, PriceWaterhouseCoopers, LLP, of St. Louis, Missouri, for its audit covering the period from January 1, 2001, through December 31, 2001. Information relied upon included attorney letters, tests of controls, and narrative descriptions of processes and controls.

Comments - Previous Examination

The previous financial examination of Shelter Mutual was conducted by the MDI for the period ending December 31, 1998. Listed below are the comments, recommendations, and notes from the previous examination report, the Company's response, and the findings in the current examination.

Fidelity Bond

Comment: It was recommended that the Company should obtain a minimum of \$1,750,000 of fidelity coverage to cover employees for dishonest acts in the normal course of business as recommended by the NAIC guidelines for the protection of its assets.

Company's Response: The Company stated that the fidelity bond coverage had been obtained as recommended.

Current Findings: The Company currently has a financial institution bond that provides fidelity coverage in excess of the minimum level recommended by the guidelines of the NAIC. Refer to the Fidelity Bond and Other Insurance section of this report for further details.

Supplemental Employee Retirement Plan

Comment: It was recommended that the Company should recognize the non-qualified Supplemental Employee Retirement Plan (SERP) assets on its balance sheet and non-admit the SERP assets. It was further recommended that the Company should disclose in the Notes to the Financial Statements of the Annual Statement that the SERP assets are subject to the claims of general creditors of the Company in the event of insolvency or Federal bankruptcy.

Company's Response: The Company stated that the assets, related obligation, and appropriate note disclosures regarding the SERP would be reflected in the 2000 financial statements. The Company further stated that payments to the SERP in excess of the amount expensed would be reported as a non-admitted asset.

Current Findings: No problems were noted in the reporting of SERP assets.

Reinsurance

Comment: It was noted that several of Shelter Mutual's ceded reinsurance contracts had insolvency clauses, which allow for the reinsurer to pay the insured directly in the event of insolvency. Such provisions in insolvency clauses were not allowed by Missouri Regulation 20 CSR 200-2.100 (11)(A) (Credit for Reinsurance). It was recommended that the Company should review and update the insolvency clauses in its reinsurance agreements.

Company's Response: The Company stated that its ceded reinsurance contracts had been reviewed and changes were being made to have them conform with Missouri Regulation 20 CSR 200-2.100 (11)(A).

Current Findings: The insolvency clause provisions of Missouri Regulation 20 CSR 200-2.100 (11) (A) were superseded by revisions made to Section 375.246 RSMo (Reinsurance Credits), effective August 28, 2002. This statute now provides for instances in which payments from a reinsurer may be made directly to an insured. The insolvency clauses for the agreements that were reviewed during the examination were found to be in compliance with Missouri statutes and regulations.

Accounts and Records

Comment: It was recommended that the Company should maintain claim files for the year in which the claim is closed plus three calendar years, in accordance with Section 374.205 RSMo (Examination of Insurers).

Company's Response: The Company stated that its retention policy and practices were revised to conform with Section 374.205 RSMo.

Current Findings: Missing claim files were discovered during a sample testing of paid claim files. Refer to the Accounts and Records section of this report for further information.

HISTORY

General

Shelter Mutual was incorporated on August 31, 1945 and was originally named M.F.A. Mutual Insurance Company. It was issued a Certificate of Authority on December 31, 1945 and commenced business on January 1, 1946. The Company's name was changed to Shelter Mutual Insurance Company on July 1, 1981. The Company operates as a mutual property and casualty insurer under the insurance laws of Chapter 379 RSMo (Insurance Other Than Life).

Capital Stock

The Company was organized as a mutual entity and therefore, does not have any capital stock ownership. The Company is owned 100% by its policyholders.

Dividends

Shelter Mutual does not have any stockholders. The Company's Bylaws allow for dividends to be paid to its policyholders. However, no dividends were declared or paid during the examination period.

Management

The management of the Company is vested in a Board of Directors that are appointed by the policyholders. The Company's Articles of Incorporation and Bylaws specify that the number of directors shall be nine. Each director must also be a policyholder of Shelter Mutual. The Board of Directors appointed and serving, as of December 31, 2001, were as follows:

<u>Name and Address</u>	<u>Principal Occupation and Business Affiliation</u>
James A. Offutt Osage Beach, MO	Chairman, Retired Executive Shelter Insurance Companies
Robert W. Maupin% Columbia, MO	Vice Chairman, Retired Executive Shelter Insurance Companies
Raymond E. Jones Columbia, MO	Executive Vice President and Secretary Shelter Insurance Companies
H. Marshall Chatfield Columbia, MO	Retired Executive Kansas City Life Insurance Company
Ann K. Covington Columbia, MO	Attorney / Partner Bryan Cave, LLP
John D. Duello Rocheport, MO	President and Chief Executive Officer Shelter Insurance Companies
Andres Jimenez Madrid, Spain	Vice President and Chief Executive Officer Mapfre Re Compania de Reaseguros, S.A.
John W. Lenox* Columbia, MO	Retired Executive Shelter Insurance Companies
Barry L. McKuin Morrliton, AR	President Morrliton Area Chamber of Commerce

* Mr. Lenox died in November 2002 and was replaced by Don A. McCubbin in April 2003
% Mr. Maupin retired in April 2003 and was replaced by Dr. Gerald Brouder in May 2003

Committees

The Bylaws require an Executive and Compensation Committee and an Audit Committee of the Board of Directors. The Bylaws also allow for other committees to be appointed by the Board of Directors as needed. An Investment Committee was in operation during and subsequent to the examination period. As of December 31, 2001, the members of each committee were as follows:

Executive and Compensation Committee

Robert W. Maupin, Chairman
J. Donald Duello
H. Marshall Chatfield
James A. Offutt
Ann K. Covington

Audit Committee

Barry L. McKuin, Chairman
Ann K. Covington
H. Marshall Chatfield

Investment Committee

J. Donald Duello, Chairman
Raymond E. Jones
Thomas Fischer
John W. Lenox
Robert W. Maupin
James A. Offutt
H. Marshall Chatfield

Officers

The officers elected by the Board of Directors and serving, as of December 31, 2001, were as follows:

John D. Duello	President and Chief Executive Officer
Raymond E. Jones	Executive Vice President and Secretary
Robert T. Cox #	Executive Vice President and General Counsel
Don A. McCubbin	Executive Vice President - Underwriting
Jerry L. French	Vice President, Treasurer and Assistant Secretary
Max T. Dills @	Vice President – Actuarial
Thomas N. Fischer	Vice President – Investments
Gary L. Ford	Vice President – Planning and Research
William C. Keithley	Vice President – Information Services
Ricky L. Means **	Vice President – Claims
John D. Moore	Vice President – Marketing
Joe L. Moseley	Vice President – Public Affairs
Gary D. Myers ***	Vice President – Administration
Donald H. Northway	Vice President – General Services
L. Gerald Brooks	Assistant Treasurer

Robert T. Cox resigned effective March 1, 2002 and was replaced by Randa C. Rawlins on April 15, 2002. Ms. Rawlins was appointed as General Counsel only.

@ Max T. Dills was elected as Vice President – Administration on February 21, 2002. S. Daniel Clapp was elected Vice President – Actuarial on that date also.

** Ricky L. Means was elected Vice President – Underwriting on February 21, 2002. Patrick D. Gruber was elected Vice President – Claims on that date also.

*** Gary D. Myers was elected Executive Vice President on February 21, 2002.

Conflict of Interest

The Company has a policy that requires all officers, directors, and key employees to complete a conflict of interest statement each year. Signed statements of officers and directors were reviewed for the examination period. No significant exceptions were noted.

Corporate Records

A review was made of the Articles of Incorporation and Bylaws for the examination period. There were no amendments or changes to the Articles of Incorporation during the period under examination. The Bylaws were amended in April 2001 to require an Audit Committee to be maintained.

The minutes of the Board of Directors' meetings, committee meetings, and policyholders' meetings were reviewed for proper approval of corporate transactions. In general, the minutes appear to properly reflect and approve the Company's major transactions and events for the period under examination.

Acquisitions, Mergers and Major Corporate Events

In 2000, the Company's subsidiary, Shelter Reinsurance, formed a 100% owned holding company subsidiary, Shelter UK Holdings, Ltd., in the United Kingdom. Shelter UK Holdings, Ltd. purchased 62% of Sterling Underwriting Agencies, Ltd., a managing agency for two Lloyd's of London syndicates. Sterling Underwriting Agencies, Ltd. was renamed Commodore Underwriting Agency, Ltd. Shelter UK Holdings, Ltd. also formed a 100% owned Lloyd's of London corporate name, Shelter Dedicated, Ltd., to accept risks for Lloyd's of London syndicates.

In 2000, the Company's 42.5% owned subsidiary, Riverside Underwriters, Plc (Riverside), an insurance broker in the United Kingdom, became insolvent due to developing substantial losses. Riverside was placed into liquidation, and as a result, Shelter Mutual's investment in Riverside was rendered worthless. Shelter Mutual surrendered its stock certificates for Riverside to the liquidation trustee in 2000.

Surplus Debentures

No surplus debentures were issued or outstanding for the period under examination.

AFFILIATED COMPANIES

Holding Company, Subsidiaries and Affiliates

The Company is a member of an Insurance Holding Company System as defined by Section 382.010, RSMo (Definitions). An Insurance Holding Company System Registration Statement was filed by Shelter Mutual, on behalf of itself and its other insurance subsidiaries, for each year of the examination period. Shelter Mutual does not have any stockholders or controlling entity due to its formation as a mutual entity. The Company is ultimately owned by its policyholders.

The operations of the Company's non-insurance subsidiaries are described as follows:

Shelter Financial Corporation (SFC) – A holding company for Shelter Bank.

Shelter Bank – A savings and loan company that sells certificates of deposits, individual retirement accounts, and provides auto loans and mortgage loans. It does not have any demand accounts (checking or savings). Its customers are mainly policyholders of Shelter Mutual and Shelter General, but customers may also come from the general public.

Shelter Financial Services, Inc. (SFS) – A holding company for Shelter Benefits Management, Inc.

Shelter Benefits Management, Inc. (Shelter Benefits) – Provides the human resource function and manages agent and employee benefits for the Shelter Insurance Companies.

Shelter Enterprises, LLC – This is a small entity (only \$6.1 million of total assets) that owns property and equipment and derives its income from leasing the assets to affiliates, including Shelter Mutual, and other non-affiliated entities.

Daniel Boone Underwriters, LLC – An insurance broker that places risks from leads generated by agents of the Shelter Insurance Companies. The risks placed are in lines of business that are not written by Shelter Mutual or Shelter General.

Daniel Boone Agency, Inc. – An insurance broker in the same manner as explained for Daniel Boone Underwriters, LLC above, except that this entity operates in Illinois only.

DBU, Inc. – An insurance broker in the same manner as explained for Daniel Boone Underwriters, LLC above, except that this entity operates in Mississippi only.

Shelter (UK) Holdings, Ltd. – A holding company for Shelter Dedicated, Ltd. and Commodore Underwriting Agencies, Ltd.

Shelter Dedicated, Ltd. – A Lloyd's of London corporate member that accepts risks for a Lloyd's syndicate. Accepted risks for the policy year from January 1, 2001 through December 31, 2001. Due to the poor experience, no other risks were accepted after 2001. The company is now in run-off with a three-year accounting period ending December 31, 2003.

Commodore Underwriting Agencies, Ltd. (Commodore) – An underwriter for risks taken by Shelter Dedicated, Ltd and other Lloyd's syndicates. As of the first quarter of 2003, the entity has no operations, employees, or significant assets.

Organizational Chart

The following table depicts the holding company system of Shelter Mutual and its subsidiaries, as of December 31, 2001:

<u>Company</u>	<u>Parent or Controlling Entity</u>	<u>Ownership</u>
Shelter Mutual Insurance Company	Policyholders	100%
Shelter General Insurance Company	Shelter Mutual Insurance Company	100%
Shelter Enterprises, LLC	Shelter General Insurance Company	45%
	Shelter Life Insurance Company	45%
	Shelter Reinsurance Company	10%
Shelter Life Insurance Company	Shelter Mutual Insurance Company	100%
Shelter Reinsurance Company	Shelter Mutual Insurance Company	100%
Shelter (UK) Holdings, Ltd.	Shelter Reinsurance Company	100%
Shelter Dedicated, Ltd.	Shelter (UK) Holdings, Ltd.	100%
Commodore UW Agencies, Ltd.	Shelter (UK) Holdings, Ltd.	100%
Shelter Financial Corporation	Shelter Mutual Insurance Company	100%
Shelter Bank	Shelter Financial Corporation	100%
Shelter Financial Services, Inc.	Shelter Mutual Insurance Company	79.5%
	Shelter General Insurance Company	11%
	Shelter Life Insurance Company	9.5%
Shelter Benefits Management, Inc.	Shelter Financial Services, Inc.	100%
Daniel Boone Underwriters, LLC	Shelter Mutual Insurance Company	40%
	Shelter General Insurance Company	40%
	Shelter Life Insurance Company	20%
Daniel Boone Agency, Inc.	Daniel Boone Underwriters, LLC	100%
DBU, Inc.	Daniel Boone Underwriters, LLC	100%

Intercompany Transactions

Shelter Mutual had the following intercompany transactions during the examination period.

- On May 13, 1999, Shelter Mutual and Shelter Life executed an Exchange Agreement in which Shelter Mutual transferred twenty-four corporate bonds and cash with a combined value (market value plus accrued interest) of \$100,223,532 to Shelter Life. In exchange, Shelter Life issued a \$100,223,532 promissory note to Shelter Mutual. The promissory note was subsequently assigned to Shelter Benefits, as part of a Transfer and Assumption Agreement, effective May 19, 1999. The Transfer and Assumption Agreement is described in the Intercompany Agreements section of this report.
- Shelter Mutual purchased \$17,148,900 of commercial paper from SFS at various times during 1999. Shelter Mutual received \$71,341 of interest on these investments.
- Shelter Mutual and Shelter General purchased structured settlements from Shelter Life during the examination period. The structured settlements were used to provide periodic payouts of claim payments due under the terms of policies issued by Shelter Mutual and Shelter General. The claimants are the beneficiaries of the contracts. Shelter Mutual and Shelter General collectively purchased \$3,500,000, \$4,000,000, and \$2,500,000 of structured settlements during 1999, 2000, and 2001, respectively.
- Shelter Mutual pledged assets as collateral against letters of credit (LOCs) in support of the international reinsurance operations of Shelter Dedicated, Ltd., during 2001 and 2002. There were no drawdowns in 2001, but drawdowns totaled \$8,637,000 in 2002. Shelter Mutual's pledged assets were \$36,175,000, as of December 31, 2001, in support of the Shelter Dedicated LOCs.
- The Company also pledged assets as collateral for LOCs in support of the operations of its former subsidiary, Riverside Underwriters, Plc, in 2000 and 2001. Drawdowns on the LOCs totaled \$10,059,933 in 2001. None of Shelter Mutual's assets remained pledged for the Riverside LOCs, as of December 31, 2001.

Intercompany Agreements

The Company's intercompany agreements in effect, as of December 31, 2001, are outlined below.

- 1. Type:** Agreement for Management Services and Facilities (five separate agreements)

Affiliates: Shelter Life, Shelter Reinsurance, SFS, SFC, Daniel Boone Underwriters, LLC (collectively referred to as the "Subsidiaries")

Effective: August 1, 1996 for Daniel Boone Underwriters, LLC
January 1, 1997 for Shelter Life, Shelter Re, and SFS
April 10, 1998 for SFC

Terms: The terms of all five agreements are identical. Shelter Mutual agrees to provide the employees to operate all aspects of the Subsidiaries. Services to be provided include recordkeeping, processing, planning, budgeting, receipt and disbursement activities, and all work incidental to the operation of the Subsidiaries' business. Shelter Mutual agrees to provide office space, utilities, computer systems, office equipment, and supplies. In exchange for the services and facilities provided by Shelter Mutual, the Subsidiaries will make monthly payments to Shelter Mutual. Payments will be calculated in accordance with the Joint Expense Allocation Agreement between Shelter Mutual and the Subsidiaries.
- 2. Type:** Agreement for Management Services and Facilities

Affiliate: Shelter Bank

Effective: April 12, 1999

Terms: Shelter Mutual agrees to provide Shelter Bank with the following services: loan processing, payroll processing, human resources, employee benefit administration, investment management and treasury, training for employees and agents, facilities management, legal, tax, internal controls, and administrative support. Shelter Mutual agrees to provide office space, utilities, computer systems, and telephone systems. Shelter Bank will pay Shelter Mutual the lower of actual costs or the fair market price for the services and facilities provided. Actual costs shall be determined on an allocation basis as defined in Exhibit D or the Joint Expense Allocation Agreement between Shelter Mutual and certain subsidiaries.

- 3. Type:** Joint Expense Allocation Agreement
- Affiliates:** Shelter General, Shelter Life, Shelter Reinsurance, SFS, Daniel Boone Underwriters, LLC, Shelter Enterprises, LLC, Daniel Boone Agency, Inc., DBU, Inc., Shelter Benefits
- Effective:** May 19, 1999
- Terms:** Each party agrees to pay its direct expenses in instances when each entity's actual usage can be determined. The parties agree to allocate any joint expenses for instances in which the identification and segregation of each entity's actual share is not practically feasible. The allocation methodologies for each category of joint expenses are as follows:
- (1) Personnel – estimated or actual time
 - (2) Real Estate – square footage and employee count
 - (3) Investment – portfolio value
 - (4) Claims Adjustment (applicable to Shelter Mutual and Shelter General only) – incurred losses
 - (5) Other Expenses – assets, employee count, or written premium
- 4. Type:** Management Services Agreement
- Affiliate:** Shelter Benefits
- Effective:** May 19, 1999
- Terms:** Shelter Benefits will provide all human resource functions, payroll processing, and benefits administration for the employees and agents of Shelter Mutual. The costs of Shelter Benefits providing services will be allocated in accordance with the Joint Expense Allocation Agreement.
- 5. Type:** Transfer and Assumption Agreement
- Affiliates:** Shelter General, Shelter Life, Shelter Benefits
- Effective:** May 19, 1999
- Terms:** Shelter General and Shelter Life paid \$3,124,245 and \$636,571, respectively, to Shelter Mutual for the purpose of transferring both companies agent termination pay liabilities. Shelter Mutual transferred certain agent liabilities and employee benefit liabilities totaling \$95,223,532, as of May 19, 1999, to Shelter Benefits. The liabilities transferred included agents termination benefits, post-retirement benefits, accrued vacation benefits, and director's retirement plan benefits. In exchange, Shelter Mutual assigned its rights to the \$100,223,532 promissory note issued by Shelter Life to Shelter Benefits. Shelter Benefits also issued 500,000 shares of preferred stock, with a total par value of \$5,000,000 to Shelter Mutual. Finally, Shelter Benefits agrees to assume future agent liabilities and employee benefit liabilities from Shelter Mutual.

- 6. Type:** Tax Allocation Agreement
- Affiliates:** Shelter General, Shelter Life, Shelter Reinsurance, SFS, SFC, Shelter Benefits, Shelter Bank
- Effective:** No stated effective date. Applicable to 1999 and subsequent tax years.
- Terms:** Shelter Mutual will file a consolidated federal income tax return on behalf of itself and its subsidiaries. The tax liability for each company will be the amount that would have been determined on a separate filing basis. The subsidiaries will pay their share of tax payments to Shelter Mutual within 10 days following any tax payments made by Shelter Mutual. Shelter Mutual will refund any amount due to the subsidiaries within 10 days after filing the consolidated return.
- 7. Type:** Memorandum of Lease Agreement
- Affiliates:** Shelter Enterprises
- Effective:** January 1, 1989
- Terms:** Shelter Enterprises agrees to lease agent signs, office furniture, and office equipment to Shelter Mutual for the purpose of Shelter Mutual subleasing the leased property to its salaried and contracted agents. Initial rental amounts for leased property are specified in a schedule to the agreement. The current lease rates for all leased property totaled \$41,425 per month, as of December 31, 2001.
- Exception:** Revisions to the rental amounts for leased property are supposed to be specified in a letter agreement. However, there was no evidence of a letter agreement for the leased property and lease rates, as of December 31, 2001. The Company is directed to comply with the terms of the agreement and execute a letter agreement with Shelter Enterprises for the current leased property and lease rates and any future revisions.
- 8. Type:** Lease Agreement
- Affiliate:** Shelter Enterprises
- Effective:** Originally from March 1, 1994 to February 28, 1999
Extended to February 28, 2002 per Addendum dated August 3, 1999
Extended to February 29, 2004 per Extension dated January 10, 2002
- Terms:** Shelter Enterprises leases storage space in Columbia, Missouri from Shelter Mutual. The lease rates to be paid by Shelter Enterprises were \$705 per month, as of December 31, 2001, and through the period ending February 29, 2004.

- 9. Type:** Lease Agreement
Affiliate: Shelter Bank
Effective: April 12, 1999 to April 12, 2002
Terms: Shelter Bank leased office space in Columbia, Missouri from Shelter Mutual. The lease rates paid by Shelter Bank were \$3,107 per month for the duration of the lease term.
- 10. Type:** Subordinated Loan
Affiliate: Commodore Underwriting Agencies, Ltd.,
The Society Incorporated by Lloyd's Act 1871
Effective: October 18, 2001
Terms: Shelter Mutual loaned £50,000 to Commodore. The loan balance can only be repaid upon the liquidation of Commodore. Upon liquidation, the loan balance can only be repaid after the claims of all other creditors have been paid.
- 11. Type:** Line of Credit Promissory Note
Affiliate: Shelter Financial Corporation
Effective: September 19, 2001
Terms: SFC extends credit to allow Shelter Mutual to borrow up to \$3,000,000, as needed. Shelter Mutual pays interest on loan amounts at a rate of 0.25% over the Targeted Federal Funds Rate on an "interim reset date", which is mutually agreed upon at the time of the advance. The principal amounts are to be paid upon demand. The outstanding loan balances were \$2,200,000, as of December 31, 2001.
- 12. Type:** Line of Credit Promissory Note
Affiliate: Shelter Financial Services, Inc.
Effective: September 19, 2001
Terms: SFS extends credit to allow Shelter Mutual to borrow up to \$8,000,000, as needed. Shelter Mutual pays interest on loan amounts at a rate of 0.25% over the Targeted Federal Funds Rate on an "interim reset date", which is mutually agreed upon at the time of the advance. The principal amounts are to be paid upon demand. The outstanding loan balances were \$800,000, as of December 31, 2001.

The Company executed additional agreements that were effective after December 31, 2001. These agreements are also outlined below:

- 1. Type:** Commercial Lease
Affiliates: Shelter Bank
Effective: April 12, 2002 to April 12, 2005
Terms: Shelter Bank leases office space in Columbia, Missouri from Shelter Mutual. The lease rates to be paid by Shelter Bank are \$4,231 per month for the duration of the lease term.
- 2. Type:** Commercial Lease
Affiliates: Shelter Enterprises
Effective: November 1, 2002 to October 31, 2003
Terms: Shelter Mutual leases storage space in Columbia, Missouri from Shelter Enterprises. The lease rates to be paid by Shelter Mutual are \$3,300 per month for the duration of the lease term.
- 3. Type:** Lease of Aircraft
Affiliates: Shelter Enterprises
Effective: May 1, 2002 to April 30, 2007
Terms: Shelter Mutual leases an airplane from Shelter Enterprises. The lease rates are \$1,191 per month for the duration of the lease term.

Shelter Mutual also has other transactions with its subsidiaries that are not subject to intercompany agreements, which are described as follows.

Shelter Mutual and its subsidiaries, except for those in the Shelter (UK) Holdings, Ltd. holding company system, are named insureds on a general liability insurance policy issued by Shelter Mutual. Premiums are charged to the subsidiaries through intercompany allocations under the Joint Expense Allocation Agreement.

Shelter Mutual has issued other insurance policies to Shelter Bank that provide property and automobile coverages. Premiums are paid directly to Shelter Mutual upon receipt of renewal notice.

Shelter Reinsurance provides earth movement coverage on all real and personal property at locations owned or used by Shelter Mutual. Premium is paid directly to Shelter Reinsurance upon receipt of renewal notice.

The Company has a Management Services and Facilities Agreements with several subsidiaries as described previously. The same services that are provided by Shelter Mutual to the subsidiaries pursuant to these agreements, are also provided to Shelter General. However, Shelter Mutual does not have a written agreement with Shelter General. The Company is directed to obtain a written agreement with Shelter General, similar to the Management Services and Facilities Agreements that exist with other subsidiaries. Such agreement should be submitted as a Form D filing to the MDI for prior approval in accordance with Section 382.195 RSMo (Transactions Within a Holding Company System).

Intercompany Payments

The following table summarizes the payments made during the exam period, between Shelter Mutual and its subsidiaries, pursuant to intercompany agreements.

Subsidiary	Agreement	Net Paid / (Received)		
		1999	2000	2001
Shelter Benefits	Management Services	\$ 3,973,551	\$ 4,133,259	\$ 4,916,083
Shelter Reinsurance	Joint Expense Allocation	(944,053)	(860,655)	(956,974)
Shelter General	Joint Expense Allocation	(16,783,813)	(15,448,232)	(15,116,456)
Shelter Life	Joint Expense Allocation	(7,519,235)	(7,466,222)	(7,876,824)
Shelter Bank	Joint Expense Allocation	(69,612)	(62,907)	(48,827)
DBU, Inc.	Joint Expense Allocation	(124,831)	(153,564)	(150,764)
DBA, Inc.	Joint Expense Allocation	(20,025)	(22,944)	(22,985)
DBU, LLC	Joint Expense Allocation	(20,025)	(22,944)	(22,985)
SFS	Joint Expense Allocation	(81,386)	(76,776)	(82,560)
Shelter Enterprises	Joint Expense Allocation	(78,429)	(83,136)	(80,326)
Shelter Benefits	Joint Expense Allocation	(201,194)	(681,816)	(691,224)
Shelter Reinsurance	Tax Allocation	637,828	(206,397)	1,208,576
Shelter General	Tax Allocation	(322,557)	(1,911,693)	521,358
Shelter Life	Tax Allocation	(875,067)	(5,944,408)	(7,456,923)
Shelter Bank	Tax Allocation	6,572	(57,383)	(171,760)
SFS	Tax Allocation	(274,801)	(185,493)	(100,931)
SFC	Tax Allocation	56,477	39,965	72,310
Shelter Benefits	Tax Allocation	(1,937,775)	(1,502,908)	(1,598,078)
Shelter Benefits	Transfer and Assumption	1,204,160	2,790,916	4,056,676
SFS	Promissory Note	0	0	800,000
SFC	Promissory Note	0	0	2,200,000
Shelter Bank	Lease	(32,824)	(46,391)	(43,284)
Shelter Enterprises	Lease	1,448,523	542,679	510,690
TOTAL		(\$21,958,516)	(\$27,227,050)	(\$20,135,208)

FIDELITY BOND AND OTHER INSURANCE

The Shelter Insurance Companies are named insureds on a financial institution bond. The bond provides employee fidelity coverage with a liability limit of \$2,500,000 and a \$50,000 deductible. This level of coverage complies with the suggested minimum amount of fidelity insurance according to NAIC guidelines.

The Shelter Insurance Companies are also named insureds on the following insurance policies: property, general liability, umbrella excess liability, automobile physical damage and liability, aircraft physical damage and liability, workers compensation and employers liability, computer crime, kidnap and ransom / extortion, and earth movement.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

As of December 31, 2001, the Company had approximately 1,700 employees and 1,400 agents. The employees work on the operations of Shelter Mutual and several subsidiaries. The agents produce business for Shelter Mutual, Shelter General, and Shelter Life. Benefit costs for employees and agents are allocated from the Company to the subsidiaries, pursuant to agreements that are described in the Intercompany Agreements section of this report.

A variety of standard benefits are provided to the employees and agents. These benefits include, but are not limited to, the following: medical insurance, dental insurance, life insurance, personal accident insurance, disability insurance, sick leave, and tuition reimbursement. Employees are also provided with a defined benefit pension plan and a 401(k) savings and profit sharing plan. Certain highly compensated employees are provided with a Supplemental Employee Retirement Plan (SERP). As of December 31, 2001, the pension plan was over funded by \$37,981,688 and the SERP was over funded by \$1,638,182.

Employees of Shelter Benefits, a subsidiary, provide various human resource functions for Shelter Mutual and its subsidiaries. Benefit costs for the Shelter Benefits employees are allocated to Shelter Mutual and its subsidiaries, pursuant to agreements that are described in the Intercompany Transactions section of this report.

Other benefits are provided to Shelter Mutual employees, agents, directors, and retirees by its subsidiary, Shelter Benefits, pursuant to an agreement described in the Intercompany Agreements section of this report. These benefits include postretirement health benefits, agents' termination benefits, directors' retirement benefits, nonqualified separation benefits, and vacation benefits. Shelter Benefits manages these benefits and records the corresponding assets and liabilities for the benefits on its financial statements. Shelter Mutual makes payments to Shelter Benefits each year for the liabilities for these benefits.

STATUTORY AND OTHER DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the Missouri Department of Insurance as of December 31, 2001, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with Section 379.098 RSMo (Securities Deposit). The funds on deposit as of December 31, 2001, were as follows:

<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
U.S. Treasury Bonds	\$2,000,000	\$2,385,620	\$2,079,733

Deposits with Other States

The Company also has funds on deposit with other states. Those funds on deposit as of December 31, 2001, were as follows:

<u>State</u>	<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
Arkansas	U.S. Treasury Bonds	\$300,000	\$357,843	\$311,960
Louisiana	U.S. Treasury Bonds	<u>100,000</u>	<u>119,281</u>	<u>103,987</u>
Total		<u>\$400,000</u>	<u>\$477,124</u>	<u>\$415,947</u>

Other Deposits

The Company has pledged assets to UMB Bank, N.A. as collateral for letters of credit in support of its subsidiary, Shelter Dedicated, Ltd.. The Company also has pledged assets to Brown Brothers Harriman as collateral for letters of credit relating to its participation in a quota share agreement through Lloyd's of London. The par values of the pledged assets for the Shelter Dedicated, Ltd. and Lloyd's of London letters of credit were \$36,175,000 and \$9,500,000, respectively, as of December 31, 2001. The pledged assets consisted of U.S. government bonds and municipal bonds.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

Shelter Mutual is licensed as a property and casualty insurer by the Missouri Department of Insurance under Chapter 379 RSMo (Insurance Other than Life). The Company is licensed and writes business in Missouri and 12 other Midwestern states, as follows:

Arkansas	Indiana	Kentucky	Nebraska
Colorado	Iowa	Louisiana	Oklahoma
Illinois	Kansas	Mississippi	Tennessee

The Company is also licensed, but does not write business, in the following states: Maryland, Michigan, Ohio, Texas, and Vermont.

The states with the largest percentage of 2001 direct written premiums were Missouri (33% of total) and Arkansas (18% of total). The major lines of business for Shelter Mutual, based upon 2001 net written premiums, are as follows:

<u>Line of Business</u>	<u>Percentage of Total Net Written Premiums</u>
Homeowners Multiple Peril	20.1%
Private Passenger Auto Liability	36.3%
Auto Physical Damage	28.1%
All Other	<u>14.7%</u>
Total	100.0%

Shelter Mutual generally writes all homeowners and preferred auto risks, while its subsidiary, Shelter General specializes in standard auto risks. There are two states that are exceptions to this plan of operations. A management decision was made to write all new auto business in Illinois and Tennessee through Shelter General in 2001.

The Company's business is produced by approximately 1,400 captive agents, which also produce business for the Shelter General and Shelter Life subsidiaries. The agents also cross-sell products for the Shelter Bank subsidiary. The Company has a marketing staff that uses various methods of advertising and direct mailings to promote the products of Shelter Mutual and its subsidiaries.

Policy Forms & Underwriting
Advertising & Sales Materials
Treatment of Policyholders

The Missouri Department of Insurance has a market conduct staff that performs a review of these issues and generates a separate market conduct report. The most recent MDI market conduct examination report was dated April 25, 2002, and covered the period from October 1, 2000 to September 30, 2001. No significant problems were noted from review of this report. The Company also had market conduct examinations from Colorado and Oklahoma during the examination period. Reports for these examinations were reviewed and no significant problems were noted.

REINSURANCE**General**

The Company's premium activity on a direct written, assumed and ceded basis, for the period under examination, is detailed below:

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Direct Business	\$684,111,633	\$696,082,028	\$750,379,121
Reinsurance Assumed:			
Affiliates	0	0	0
Non-affiliates	19,767,204	32,596,192	35,143,551
Reinsurance Ceded:			
Affiliates	(19,829,244)	(32,885,396)	(29,594,066)
Non-affiliates	<u>(15,593,979)</u>	<u>(17,858,860)</u>	<u>(23,396,733)</u>
Net Premiums Written	<u>\$668,455,613</u>	<u>\$677,933,964</u>	<u>\$732,531,873</u>

Assumed

Shelter Mutual assumes business from several U.S. and foreign companies. Business assumed from the Mutual Reinsurance Bureau (MRB) accounted for 63% of total assumed premiums in 2001. The MRB was an association of six mutual insurance companies, including Shelter Mutual. The MRB business was assumed pursuant to the Articles of Association, Bylaws and Assuming Contract, effective January 1, 2000. Shelter Mutual terminated its participation in the MRB, effective December 31, 2001.

Shelter Mutual has a fronting arrangement with its subsidiary, Shelter Reinsurance. Under this arrangement, most of reinsurance assumed by Shelter Mutual is retroceded 100% to Shelter Reinsurance. The only assumed business that is not retroceded to Shelter Reinsurance is that from involuntary pools and from Lloyd's Syndicate No. 529. Refer to the Ceding section of this report for further information on the fronting agreement.

Ceded

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under the reinsurance agreement.

Shelter Mutual has an agreement, effective January 1, 1987, with its subsidiary, Shelter Reinsurance, in which Shelter Mutual acts as a fronting company for Shelter Reinsurance. Shelter Mutual retrocedes 100% of the risks from its entire book of assumed business to Shelter Reinsurance, except for business from involuntary pools and Lloyd's Syndicate No. 529.

Shelter Mutual has several reinsurance agreements under which it cedes its direct business. The Company's subsidiary, Shelter General is also a named reinsured on these agreements. Shelter General does not directly pay reinsurance premiums to the reinsurers and does not directly receive loss recoveries. Rather, Shelter Mutual pays the total premium to the reinsurers on behalf of itself and Shelter General. Likewise, any loss recoveries are paid directly to Shelter Mutual. Shelter General is allocated reinsurance premiums and loss recoveries, but there is no written intercompany agreement for this arrangement. Shelter Mutual is directed to obtain an intercompany agreement with Shelter General for the allocation of reinsurance premiums and loss recoveries for the joint reinsurance agreements. Such agreement should be submitted as a Form D filing to the MDI for prior approval in accordance with Section 382.195 RSMo (Transactions Within a Holding Company System).

Shelter Mutual and Shelter General have an excess reinsurance agreement, originally effective January 1, 1975, with Employers Reinsurance Corporation (ERC) that appears to cover auto liability and general liability risks. The retention appears to be \$500,000 or \$625,000 per occurrence depending on the amount of loss adjustment expenses. ERC's liability appears to be

limited to \$4,000,000 in excess of the retention. The reinsured lines of business, the Company's retention, and the reinsurance limits are not clearly defined because of the 44 amendments that have taken place since the inception of the agreement in 1975. The terms of the agreement are subject to interpretation because it is impossible to tie together the disjointed and confusing terminology from all of the amendments and the original body of the agreement together in a coherent manner. It is recommended that this agreement should be restated in its entirety so that the reinsured lines of business, retentions, and limits are clearly defined.

Shelter Mutual and Shelter General have a quota share / excess agreement with ERC, effective October 1, 1985, that covers personal umbrella, personal liability, professional liability, and excess medical expense risks. Shelter Mutual and Shelter General retain 5% of the first \$1,000,000 of losses while ERC assumes the remaining 95%. The next \$1,000,000 of losses in excess of the first \$1,000,000 are ceded 100% to ERC.

Shelter Mutual and Shelter General have a quota share, property agreement, effective April 1, 2001, with Mapfre Re Compania de Reaseguros, S.A. (Mapfre Re) and Sumitomo Marine Re Management (Sumitomo). The agreement covers homeowners, farmowners, inland marine, commercial habitational, and commercial property risks with insured values between \$350,000 and \$500,000. Shelter General is a party to the agreement but it is effectively not covered since it does not write these lines of business. The Company cedes 14.5% of the covered property risks to Mapfre Re, 5% to Sumitomo, and retains the remainder. This agreement was terminated, effective December 31, 2002.

Shelter Mutual and Shelter General have a surplus property agreement, effective April 1, 2001, with five reinsurers. The reinsurers with participation percentages are as follows: Mapfre Re (75.5%), Hannover Re (5%), Sumitomo Marine Re Management (5%), Folksam International (10%) and Shelter Reinsurance (4.5%). The agreement covers homeowners, farmowners, inland marine, commercial habitation, and commercial property risks. Shelter General is a party to the agreement but it is effectively not covered since it does not write these lines of business. The Company retains \$500,000 of insured value per risk and the reinsurers are liable for the 100% of the risk above the retention with a reinsurance limit of \$3,000,000 per risk. This agreement was terminated, effective December 31, 2002.

Shelter Mutual and Shelter General have a two-layer excess agreement, effective January 1, 2003, with General Reinsurance Company. This agreement replaces the quota share and surplus property agreements that were both terminated, effective December 31, 2002, as described above. Various property risks are covered by this agreement. Shelter General is a party to the agreement, but only has immaterial business in the fire and allied lines that are covered. The main covered risks are the homeowners and other property risks written by Shelter Mutual. Under the first layer of coverage, the retention is \$500,000 per risk and the reinsurer covers the next \$1,500,000 of net losses per risk not to exceed \$4,500,000 total per occurrence. Under the second layer of coverage, the retention is \$2,000,000 per risk and the reinsurer covers the next \$1,500,000 of net losses per risk not to exceed \$3,000,000 total per occurrence.

Shelter Mutual and Shelter General have a five-layer, catastrophe excess of loss agreement, effective January 1, 2001, with several reinsurers. The participation of each reinsurer is defined in an Interest and Liabilities Agreement with each reinsurer. The agreement covers all property risks including auto physical damage. The reinsurance coverages for the combined subject net losses of Shelter Mutual and Shelter General for each layer are as follows:

<u>Layer</u>	<u>Subject Net Losses</u>	<u>Reinsurance %</u>
First	\$9,000,000 excess of \$14,000,000	95%*
Second	\$15,000,000 excess of \$23,000,000	95%
Third	\$22,000,000 excess of \$38,000,000	95%
Fourth	\$41,000,000 excess of \$60,000,000	95%
Fifth	\$15,000,000 excess of \$101,000,000	100%

* Reinsurer's participation was only 66.5% for the first layer. Actual reinsurance coverage is 66.5% of 95% or 63.175%.

The catastrophe agreements are renewed each year. Effective with the January 1, 2002 renewal, the reinsurance coverages for the combined subject net losses of Shelter Mutual and Shelter General for each layer are as follows:

<u>Layer</u>	<u>Subject Net Losses</u>	<u>Reinsurance %</u>
First	\$10,000,000 excess of \$25,000,000	95%
Second	\$15,000,000 excess of \$35,000,000	95%
Third	\$25,000,000 excess of \$50,000,000	95%
Fourth	\$40,000,000 excess of \$75,000,000	95%
Fifth	\$20,000,000 excess of \$115,000,000	100%

Effective with the January 1, 2003 renewal, the reinsurance coverages for the combined subject net losses of Shelter Mutual and Shelter General for each layer are as follows:

<u>Layer</u>	<u>Subject Net Losses</u>	<u>Reinsurance %</u>
First	\$10,000,000 excess of \$25,000,000	95%
Second	\$15,000,000 excess of \$35,000,000	95%
Third	\$30,000,000 excess of \$50,000,000	95%
Fourth	\$40,000,000 excess of \$80,000,000	95%
Fifth	\$65,000,000 excess of \$120,000,000	95%
Sixth	\$20,000,000 excess of \$185,000,000	100%

ACCOUNTS AND RECORDS

General

The CPA firm, PricewaterhouseCoopers, LLP, of St. Louis, Missouri, issued audited statutory financial statements of the Company for all years in the examination period.

The reserves for losses and loss adjustment expenses were reviewed and certified by Terrence M. O'Brien, FCAS, MAAA, CPCU for all years in the examination period. Mr. O'Brien is employed by PricewaterhouseCoopers, LLP, of Chicago, Illinois.

Claim Files

A statistical sample of claims paid in 2001 was selected from data supporting Schedule P of the Annual Statement for Shelter Mutual and Shelter General. The Company was unable to locate three claim files and several months of research were required to locate other claim files. If the results from this statistical sample was extrapolated to the entire population of paid claims, then the Company would appear to have numerous claim files that are either missing or not filed properly. Section 374.205.2(2) RSMo (Examination of Insurers) requires insurers to maintain claim files for the year in which the claim is closed, plus 3 calendar years. The Company should review its procedures for the filing, maintenance, and retention of claim files and improve these procedures to ensure that all claim files are retained in accordance with the cited law.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of Shelter Mutual for the period ending December 31, 2001. Any examination adjustments to the amounts reported in the financial statements and/or comments regarding such are made in the “Notes to the Financial Statements.” The failure of any column of numbers to add to its respective total is due to rounding or truncation.

There may have been additional differences found in the course of this examination, which are not shown in the “Notes to the Financial Statements.” These differences were determined to be immaterial concerning their effect on the financial statements, and therefore, were only communicated to the Company and noted in the workpapers for each individual Annual Statement item.

Assets as of December 31, 2001

	<u>Assets</u>	Non-Admitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$616,549,414	\$0	\$616,549,414
Preferred Stocks	21,122,048	0	21,122,048
Common Stocks	499,144,267	0	499,144,267
Real Estate	44,351,860	0	44,351,860
Cash and Short-term Investments (Note 1)	42,036,197	0	42,036,197
Other Invested Assets	78,854,059	0	78,854,059
Agg. Write-ins for Invested Assets:			
Financial Futures Option	40,000	0	40,000
Agents' Balances or Uncollected Premiums:	43,081,139	0	43,081,139
Funds Held By or Dep. with Reinsured Co.'s	266,000	0	266,000
Reinsurance Recoverables on Losses and LAE	4,434,666	0	4,434,666
Federal Income Tax Recoverable	805,677	0	805,677
Guaranty Funds Receivable or on Deposit	3,690,502	2,079,646	1,610,856
EDP Equipment and Software	4,902,020	0	4,902,020
Investment Income Due and Accrued	11,544,679	0	11,544,679
Receivable from Parent, Sub., and Affiliates	4,076,171	0	4,076,171
Equities and Deposits in Pools and Assoc.	933,532	0	933,532
Other Assets Non-Admitted	2,373,095	2,373,095	0
Agg. Write-Ins for Other than Invested Assets:			
Missouri Affordable Housing Project Fund	13,333,880	0	13,333,880
Company Owned Vehicles	6,624,673	0	6,624,673
Supp. Employees Retirement Plan	10,295,867	0	10,295,867
Kentucky Assigned Claims Plan	141,434	0	141,434
Prepaid Retirement	10,571,479	10,571,479	0
Prepaid Supplemental Retirement	1,914,960	1,914,960	0
Accounts Receivable Reinsurance Balances	603,034	0	603,034
Due from Dispute Resolution	14,190,622	14,190,622	0
General Accounts Receivable	215,253	52,988	162,265
TOTAL ASSETS	<u>\$1,436,096,528</u>	<u>\$31,182,790</u>	<u>\$1,404,913,738</u>

Liabilities, Surplus and Other Funds as of December 31, 2001

Losses	\$ 249,529,179
Loss Adjustment Expenses	47,913,141
Commissions Payable	21,543,761
Other Expenses	6,849,659
Taxes, Licenses and Fees	4,096,538
Federal Income Taxes	5,597,032
Unearned Premiums	235,141,257
Ceded Reinsurance Premiums Payable	479,160
Amounts Withheld or Retained	1,596,739
Drafts Outstanding	23,791,252
Payable to Parent, Subsidiaries and Affiliates	3,838,353
Aggregate Write-Ins for Liabilities:	
Catastrophe Reserve – Earthquake	23,948,186
Advance Premium	13,416,705
Premium Deficiency Reserve	38,832
Supplemental Employee Retirement Plan	10,295,867
Accounts Payable Miscellaneous	<u>8,900,453</u>
TOTAL LIABILITIES	\$ 656,976,114
Aggregate Write-Ins for Other Surplus Funds	1,250,000
Unassigned Funds (Surplus)	<u>746,687,624</u>
Surplus as Regards Policyholders	<u>\$ 747,937,624</u>
TOTAL LIABILITIES AND SURPLUS	<u>\$1,404,913,738</u>

Statement of Income

For the Year Ended December 31, 2001

Premium Earned	\$708,393,180
DEDUCTIONS:	
Losses Incurred	569,890,378
Loss Expenses Incurred	56,630,449
Other Underwriting Expenses Incurred	206,814,021
Aggregate Write-Ins for Underwriting Deductions	<u>(2,334,264)</u>
Total Underwriting Deductions	<u>\$831,000,584</u>
Net Underwriting Loss	(\$122,607,404)
 Net Investment Income Earned	 55,974,887
Net Realized Capital Gains	<u>74,336,921</u>
Net Investment Gain	\$130,311,808
 Other Income	 3,706,883
Federal Income Taxes Incurred	<u>(12,016,543)</u>
 Net Income	 <u>\$23,427,830</u>
 CAPITAL AND SURPLUS ACCOUNT:	
Surplus as Regards Policyholders, December 31, 2000	\$885,663,238
Net Income	23,427,830
Net Unrealized Capital Gains or (Losses)	(88,790,049)
Change in Net Deferred Income Tax	(6,683,019)
Change in Non-Admitted Assets	(17,116,255)
Cumulative Effect of Changes in Accounting Principle	(48,821,423)
Aggregate Write-in for Gains and Losses in Surplus:	
Change in Net Foreign Exchange Gain	<u>257,302</u>
Surplus as Regards Policyholders, December 31, 2001	<u>\$747,937,624</u>

Notes to the Financial Statements

Note 1 – Cash and Short-Term Investments

\$42,036,197

Commercial paper investments of Shelter Mutual, Shelter General, and Shelter Life are commingled in a single investment account with Merrill Lynch. The total cost basis of the account was \$50,421,557, as of December 31, 2001. The Company represented that \$35,976,388 of the account value was attributable to Shelter Mutual. Pooled investments are allowed pursuant to Section 379.083 RSMo (Investment Pools). However, the pooled investments must meet the requirements of this statute and a pooling agreement must be in place. Shelter Mutual does not have a pooling agreement with its subsidiaries. The Company is directed to immediately submit a pooling agreement to the MDI for prior approval, as required by Section 379.083 RSMo, and ensure that the agreement complies with this statute.

Examination Changes

None.

General Comments and/or Recommendations

Lease with Shelter Enterprises (page 16)

Property leased from Shelter Enterprises and the corresponding lease rates, as of December 31, 2001, were not specified in a written letter agreement, as required by the Memorandum of Lease Agreement, originally effective January 1, 1989. The Company is directed to comply with the terms of the agreement and execute a letter agreement with Shelter Enterprises for the current leased property and lease rates and any future revisions.

Intercompany Transactions with Shelter General (page 19)

The same services that are provided by Shelter Mutual to various subsidiaries, pursuant to Management Services and Facilities Agreements, are also provided to Shelter General. However, Shelter Mutual does not have a written agreement with Shelter General. The Company is directed to obtain a written agreement with Shelter General, similar to the Management Services and Facilities Agreements that exist with other subsidiaries. Such agreement should be submitted as a Form D filing to the MDI for prior approval in accordance with Section 382.195 RSMo (Transactions Within a Holding Company System).

Joint Reinsurance Agreements with Shelter General (page 26)

Shelter Mutual and Shelter General have several joint reinsurance agreements. Shelter General does not directly pay reinsurance premiums to the reinsurers and does not directly receive loss recoveries. Shelter General is allocated reinsurance premiums and loss recoveries, but there is no written intercompany agreement for this arrangement. Shelter Mutual is directed to obtain an intercompany agreement with Shelter General for the allocation of reinsurance premiums and loss recoveries for the joint reinsurance agreements. Such agreement should be

submitted as a Form D filing to the MDI for prior approval in accordance with Section 382.195 RSMo (Transactions Within a Holding Company System).

Reinsurance Agreement with ERC (page 27)

The Company's excess reinsurance agreement with ERC, originally effective January 1, 1975, is disjointed and has confusing terminology. The 44 amendments to this agreement cannot be tied to the body of the original agreement in any coherent manner. As a result, the reinsured lines of business, the Company's retention, and the reinsurance limits are not clearly defined. It is recommended that this agreement should be restated in its entirety so that the reinsured lines of business, retentions, and limits are clearly defined.

Missing Claim Files (page 30)

The Company was unable to locate three claim files and several months of research were required to locate other claim files for a statistical sample of the paid claims data supporting Schedule P of the Annual Statement. The Company appears to have numerous claim files that are either missing or improperly filed based upon the results of this sample. Section 374.205.2(2) RSMo (Examination of Insurers) requires insurers to maintain claim files for the year in which the claim is closed, plus 3 calendar years. The Company should review its procedures for the filing, maintenance, and retention of claim files and improve these procedures to ensure that all claim files are retained in accordance with the cited law.

Pooled Investments (page 35)

Commercial paper investments of Shelter Mutual, Shelter General, and Shelter Life are commingled in a single investment account with Merrill Lynch. Pooled investments are allowed pursuant to Section 379.083 RSMo (Investment Pools). However, the pooled investments must meet the requirements of this statute and a pooling agreement must be in place. Shelter Mutual does not have a pooling agreement with its subsidiaries. The Company is directed to immediately submit a pooling agreement to the MDI for prior approval, as required by Section 379.083 RSMo, and ensure that the agreement complies with this statute.

ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of Shelter Mutual Insurance Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Shawn Hernandez, CFE, Shannon Schmoeger, CFE, Steve Koonse, CFE, Mark Nance, CFE, Andy Balas, CFE, Barbara Bartlett, and James Smith, examiners for the Missouri Department of Insurance, also participated in this examination. The firm of Expert Actuarial Services, LLC, also participated as a consulting actuary.

VERIFICATION

State of Missouri)
)
County of)

I, Tim L. Tunks, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of Shelter Mutual Insurance Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Tim L. Tunks, CPA, CFE
Examiner-In-Charge
Missouri Department of Insurance

Sworn to and subscribed before me this _____ day of _____, 2003.

My commission expires: _____

Notary Public

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

Frederick G. Heese, CFE, CPA
Audit Manager
Missouri Department of Insurance